

**University of Iowa Hospitals and Clinic**  
**Executive Board Committee Memorandum**  
Board of Regents, State of Iowa

**Subject:** FY 2005 Hospitals and Clinics Operating Budget Issues and Proposed Rate Increases

**Prepared by:** Deb A. Hendrickson

**Date Submitted:** May 10, 2004

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**Recommended Action:**

Recommend that the Board approve a 9.5% rate increase, effective July 1, 2004, for the University of Iowa Hospitals and Clinics, Psychiatric Hospital, and the Center for Disabilities and Development.

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**Executive Summary:**

**Budget Issues** The University will provide a brief review of key operating indicators for FY 2004 and a review of the budget issues for FY 2005.

**Proposed Rate Increase** The University is proposing a rate increase of 9.5% for patient services for UIHC, the Psychiatric Hospital, and the Center for Disabilities and Development. This increase is the same percentage increase that was approved by the Board for this fiscal year.

The University's supporting data for the increase includes:

- A 9.5% rate increase translates to less than 1.5% actual increase in net patient revenue.
- UIHC continues to lag academic medical center peers and historical state-wide rate increases.
- University HealthSystem Consortium members (UHC) anticipate rate increases in the 7-20% range, averaging greater than 10%.

The University has provided further information regarding this rate increase beginning in section 3, page 25 of the attachment.

**UIHC FY 2003 Audit** The UIHC FY 2003 audit is presented this month to the Audit Committee (AUD 4).

The audit indicated that the financial statements present fairly, in all material respects, the financial position of UIHC as of June 30, 2003 and 2002 and the changes in its net assets and its cash flows for the years then ended.

No significant audit adjustments or findings were reported.

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# **Agenda**

Brief review of key operating indicators for FY 2004

Review budget issues for FY 2005

Approval of gross charge increase for FY 2005

## **Summary of FY 2004 Operating Indicators**

UIHC has experienced increased inpatient and outpatient volumes

Market share has continued to grow in both the State and primary service area

The acuity of the patients served remains relatively high

Length of stay has dropped by .31 days, which has a positive economic effect on UIHC

Increased nurse recruitment and retention has led to lower agency utilization

Patient billing system is stabilizing

Projected to finish FY 2004 with a 1.6% Operating Margin or \$9.95 million

## Six Year Summary of Operations

	1998-99	1999-00	2000-01	2001-02	2002-03	Nine Months Ended March 31, 2004	Projected Fiscal Year 2004
<b>**Acute Admissions</b>	23,399	23,179	23,286	23,388	24,104	19,062	25,574
<b>**Length of Stay</b>	7.34	7.48	7.51	7.59	7.24	6.93	6.93
<b>Surgical Cases</b>	17,537	18,217	18,986	19,814	20,269	15,352	20,621
<b>Clinic Visits</b>	545,496	570,065	592,752	615,242	631,443	490,663	653,688
<b>Market Share</b>	6.3%	6.1%	6.1%	6.2%	6.7%	N/A	N/A
<b>Net Patient Revenue</b>	\$432.7M	\$457.1M	\$506.9M	\$525.2M	\$547.2M	\$418.3M	\$590.4M
<b>Operating Margin</b>	5.8%	5.1%	3.5%	2.0%	1.4%	1.1%	1.6%
<b>Case Mix Index*</b>							
<b>All Acute Inpatients</b>	1.5586	1.5569	1.5712	1.5866	1.6272	1.5983	1.5993
<b>Medicare Inpatients</b>	1.7243	1.7414	1.7778	1.7602	1.8182	1.7844	1.7814

\*Case mix index is a national (Medicare) measure of inpatient severity, where the average case intensity is 1.0

\*\* All years presented excludes newborn nursery utilization.

## Aa Bond Rating Key Financial Ratio Comparison

	Audited UIHC FY 1999	Audited UIHC FY 2000	Audited UIHC FY 2001	Audited UIHC FY 2002	Audited UIHC FY 2003	UIHC Mar 04 YTD	UIHC FY 04 Projected	Median Moody's Aa Rating*
Days Cash on Hand	252.5	257.2	244.1	239.4	221.1	218.0	220.0	219.8
Operating Margin	6.0%	5.3%	3.6%	2.0%	1.4%	1.1%	1.6%	2.5%
Debt to Capitalization Percent	2.3%	2.6%	2.1%	1.6%	4.3%	4.0%	4.5%	34.3%
Days in Accounts Receivable	76.7	79.1	69.1	67.3	101.3	77.9	75.0	62.2
Average Age of Plant	9.9	9.0	7.9	8.9	9.0	9.5	9.0	8.8

\*Data is compiled from Moody's Investors Service publication "Not for Profit Healthcare: 2003 Outlook and Medians."

# **FY 2005 Operating Budget Assumptions**

## **Revenues**

### **Volume growth**

Inpatient admissions 3.5% increase

Outpatient visits 5.0% increase

Revenue growth per unit of service 3.0%

Reduction in length of stay 1/2 day

Bad debts @ 3.0% of charges

Payer mix stable

State appropriation the same with no increase

Medicare prescription drug act

Potential for drug cost inflation

## FY 2005 Operating Budget Assumptions

### Costs

Salary & fringe benefit increases 4% - 6% increase

Agency Expense No increase in agency utilization

Length of Stay decreases by 0.5 day

### Supply Chain

Unfunded regulatory mandates (patient safety & emergency preparedness)

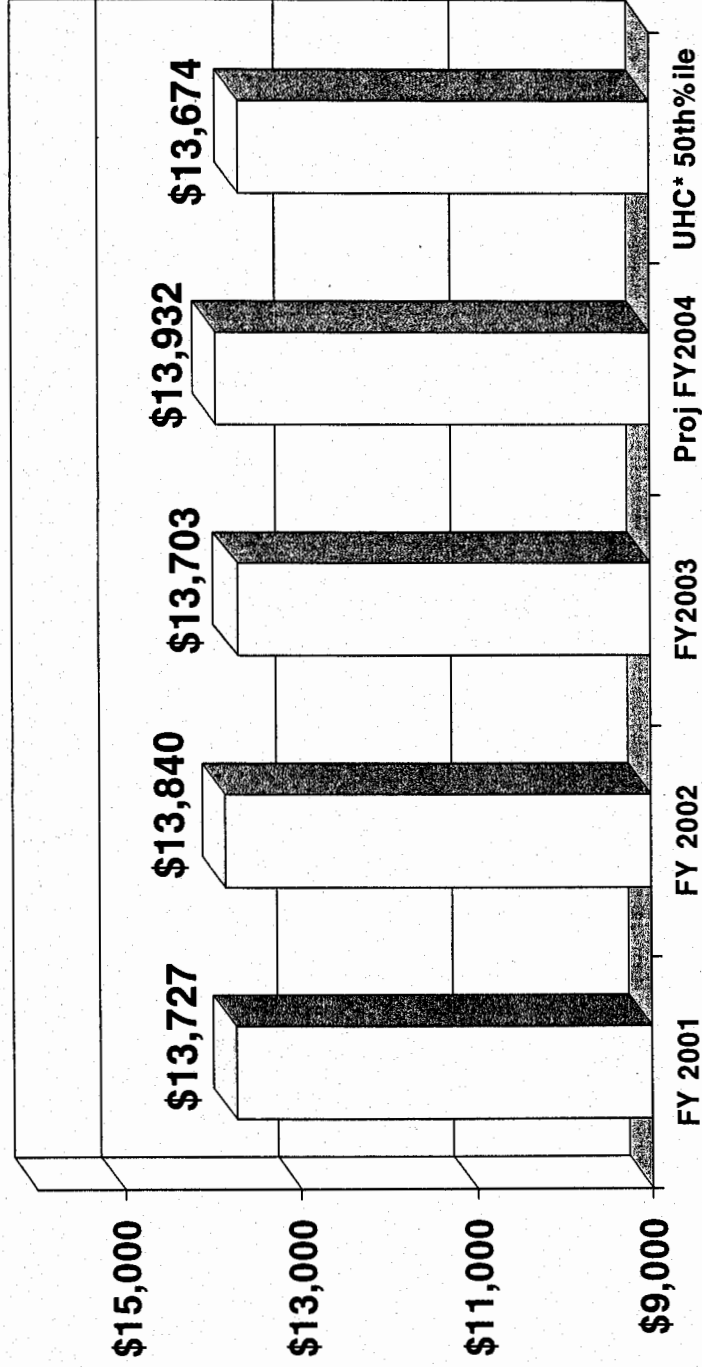
Recruitment and retention of quality patient care staff

Inflationary increases in drug & medical supplies / implants 4% – 10%

Utilities 6% – 10% increase

# Patient Revenues per Unit of Service

## Net Patient Revenue\*\* per Adjusted Discharge

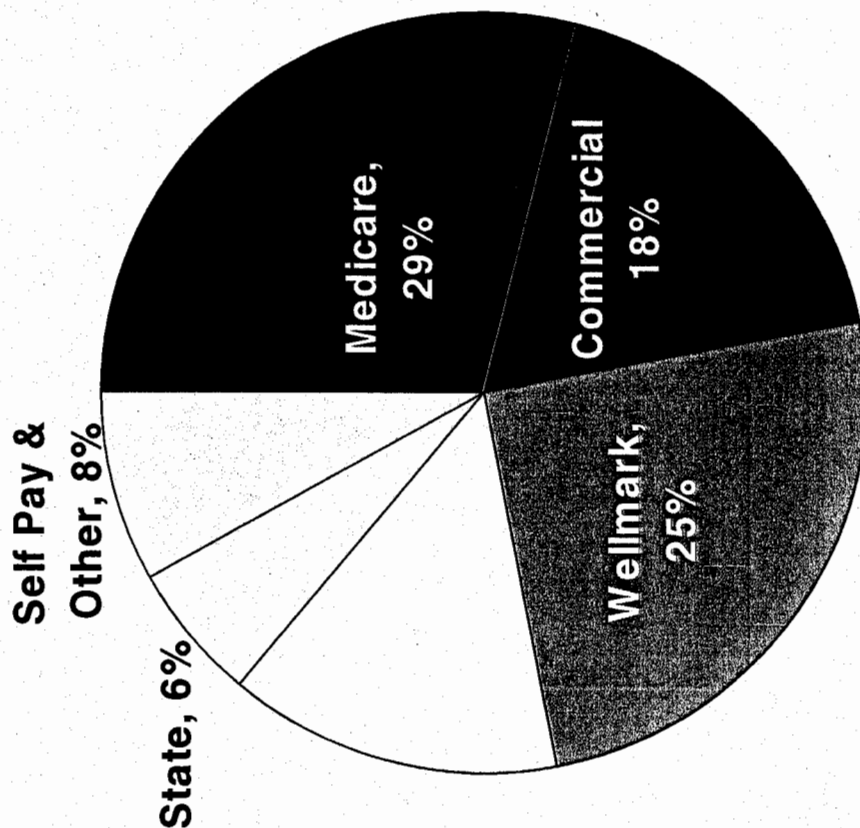


\* Benchmark is the 50<sup>th</sup> percentile of the University Health System Consortium for the two quarter ending Dec 2003.

\*\* Net paying patient revenue plus chapter 255 state indigent patient care program appropriation receipts.



## Gross Patient Charges By Primary Payor

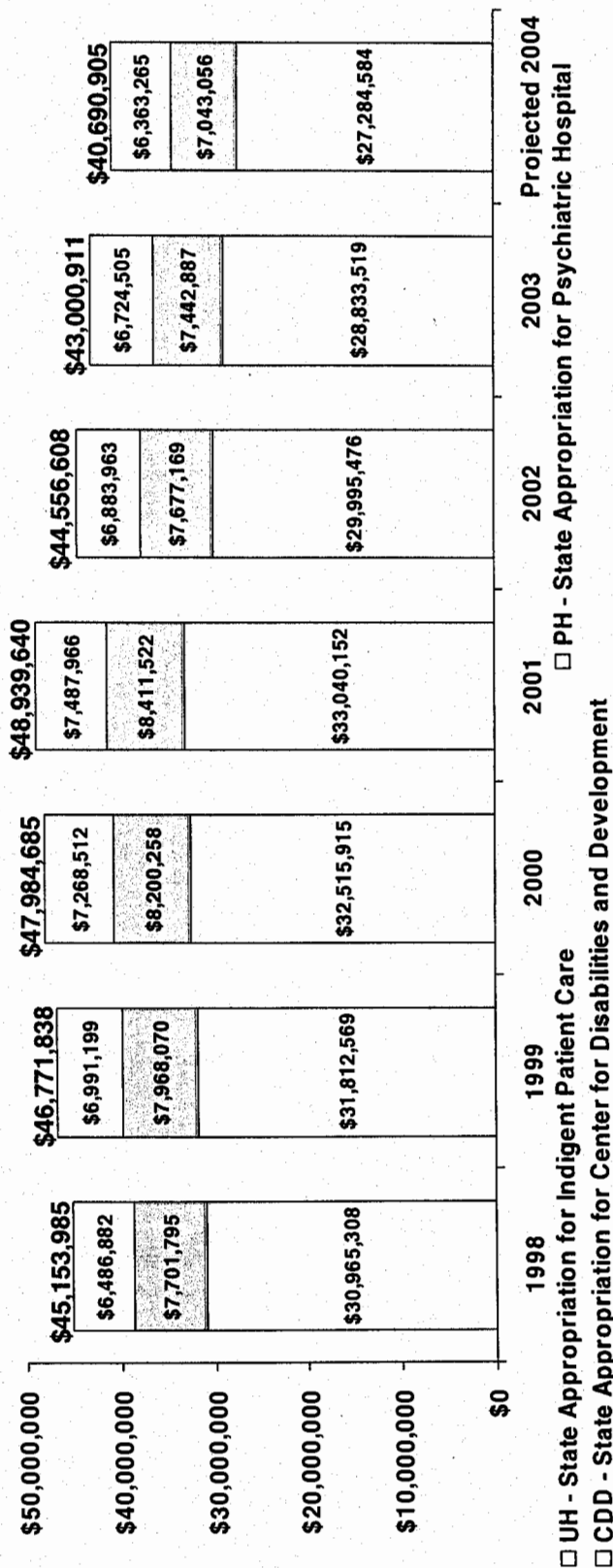


**Year to Date March, 2004**

## STATE APPROPRIATIONS

### Actual Dollars - Combined Hospital Units

INDIGENT PATIENTS SERVED						
1998	1999	2000	2001	2002	2003	2004 (proj)
36,894	34,173	32,703	33,743	34,601	37,559	39,200



## **FY 2005 Revenue Plan**

### **Focused Revenue Growth**

Capital prioritization process targets 20% return on investment

Focused business plans for Cardiovascular, Neurosurgery, Orthopedic and Oncology service lines

Addition of two new operating rooms, extended hours

Opening of Radiation Oncology Center of Excellence

Opening of new "world class" Labor and Delivery, Neonatal ICU, and Pediatric ICU

Expansion of eight Surgical Intensive Care Unit beds; four Intermediate Pulmonary Care Unit beds

Addition of eight telemetry beds

Investment in Radiology will provide state-of-art technologies and increase throughput

## **FY 2005 Revenue Plan**

### **Cash Acceleration and Revenue Cycle Redesign**

**Projects Underway with the assistance of First Consulting Group (FCG)**

**Outsource Vendor Strategy**

**Documentation Accuracy/ Coding with 3M**

**Insurance Verification/ Authorization**

**Addition of Health Benefit Advisors**

**Upfront Cash Collections**

**Review of Charge Master**

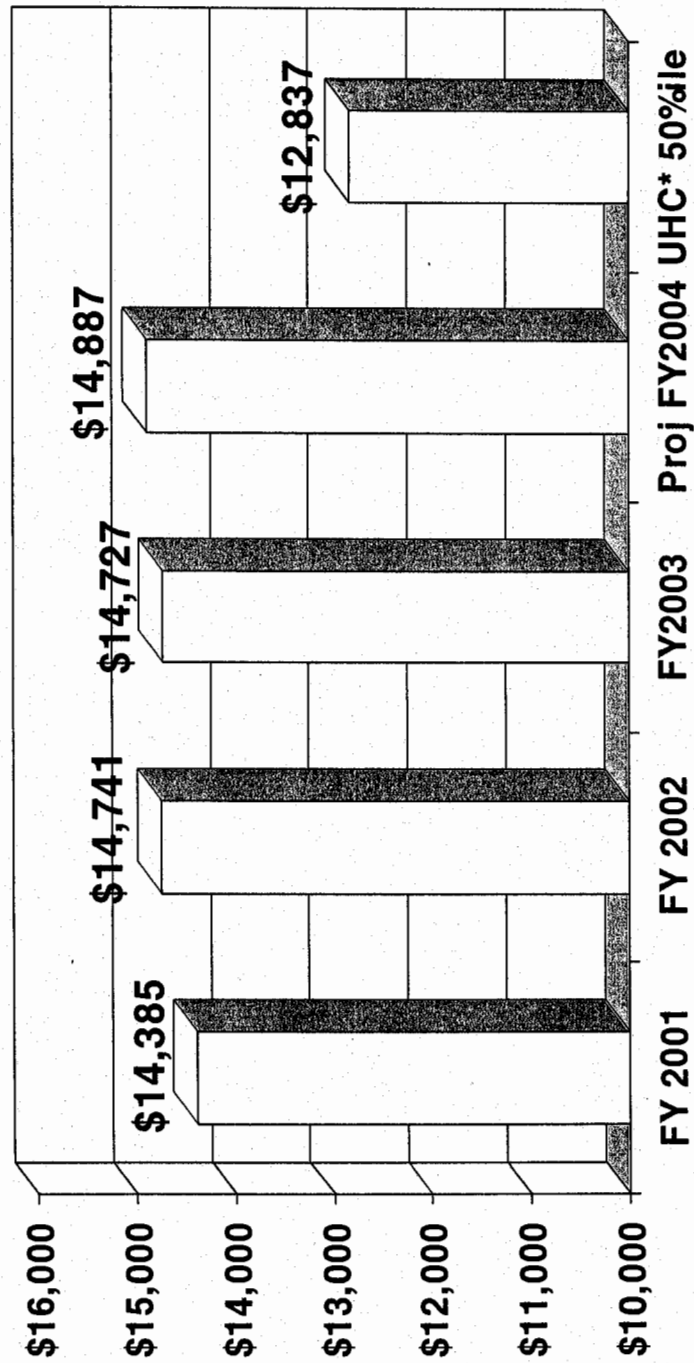
**Managed Care Underpayments**

**Development of Revenue Integrity Department**

**Focused efforts in Managed Care Contracting Strategy**

# Operating Cost per Unit of Service

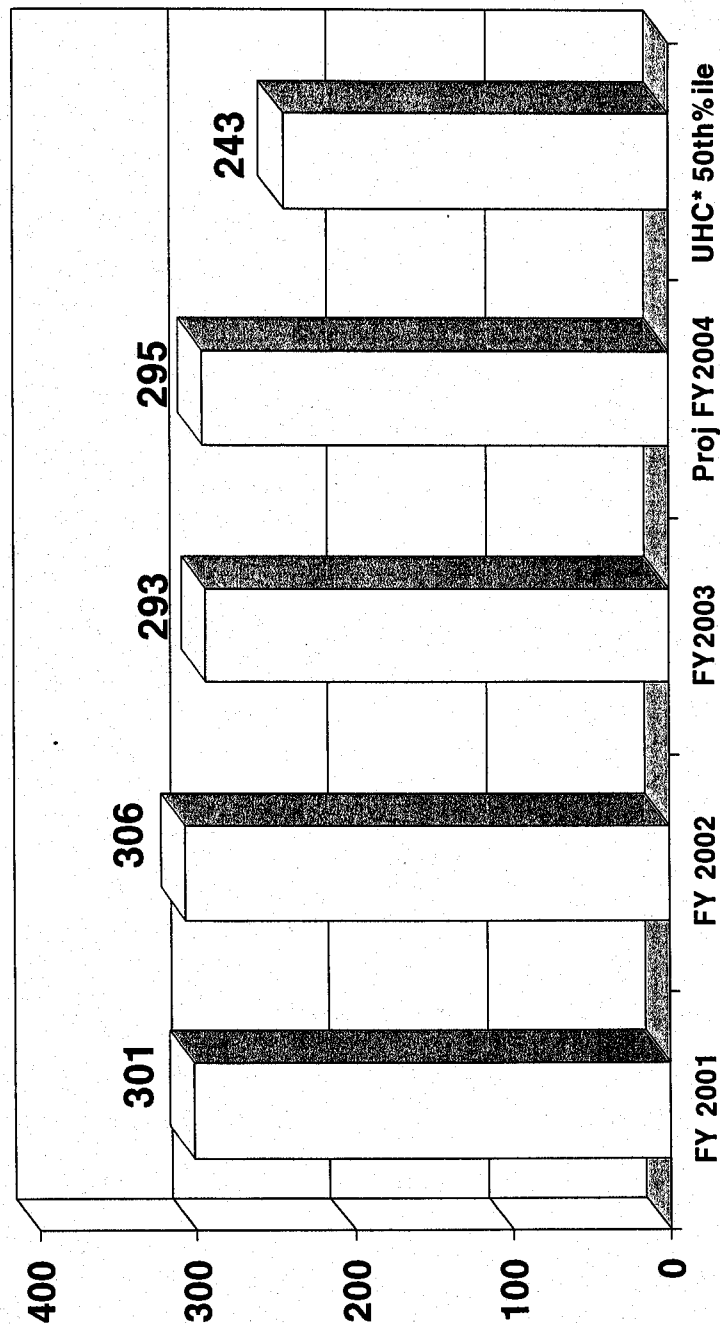
## Cost per Adjusted Discharge



\* Benchmark is the 50<sup>th</sup> percentile of the University Health System Consortium for the quarter ended Dec. 2003.

# Operating Costs per Unit of Service

## Hours Paid per Adjusted Discharge

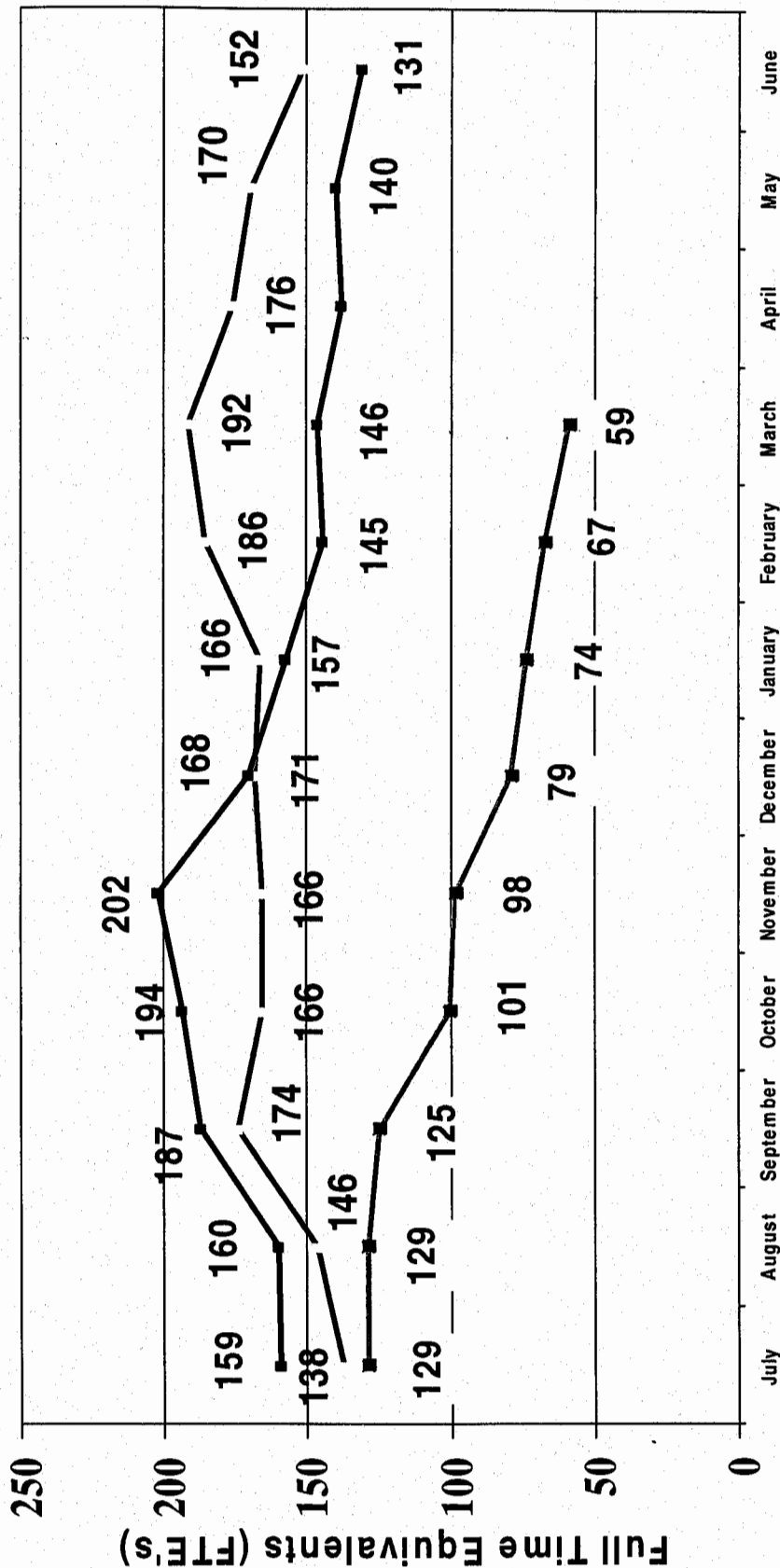


\* Benchmark is the 50<sup>th</sup> percentile of the University Health System Consortium for the four quarters ending Dec 2003.

# Reducing Agency Staff Use

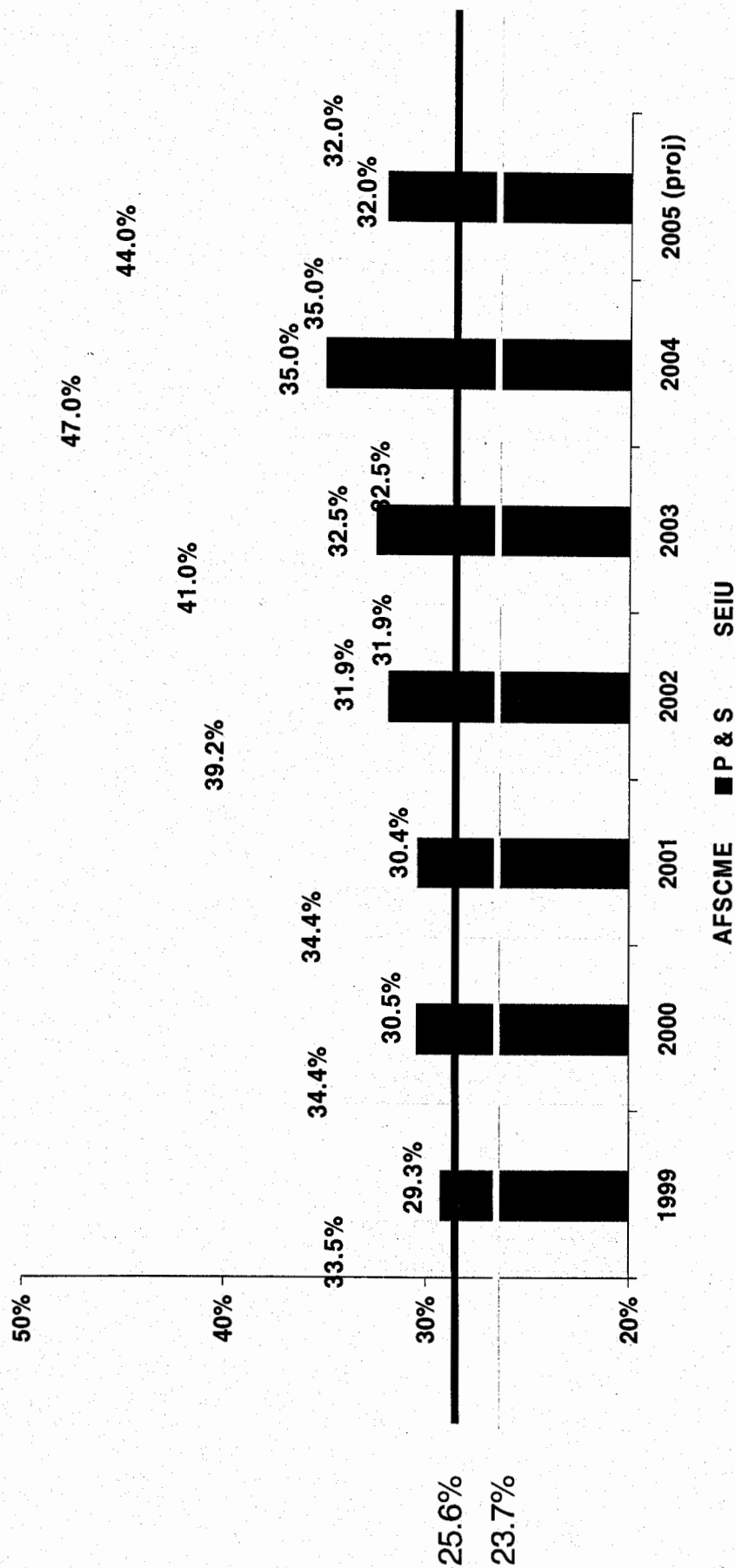
## Total Monthly Agency Staff FTE's

FY 2002 - 2004



--- FY2002    — FY2003    —■ FY2004

# Aggregate Fringe Benefit Costs as a Percent of Salary Dollar



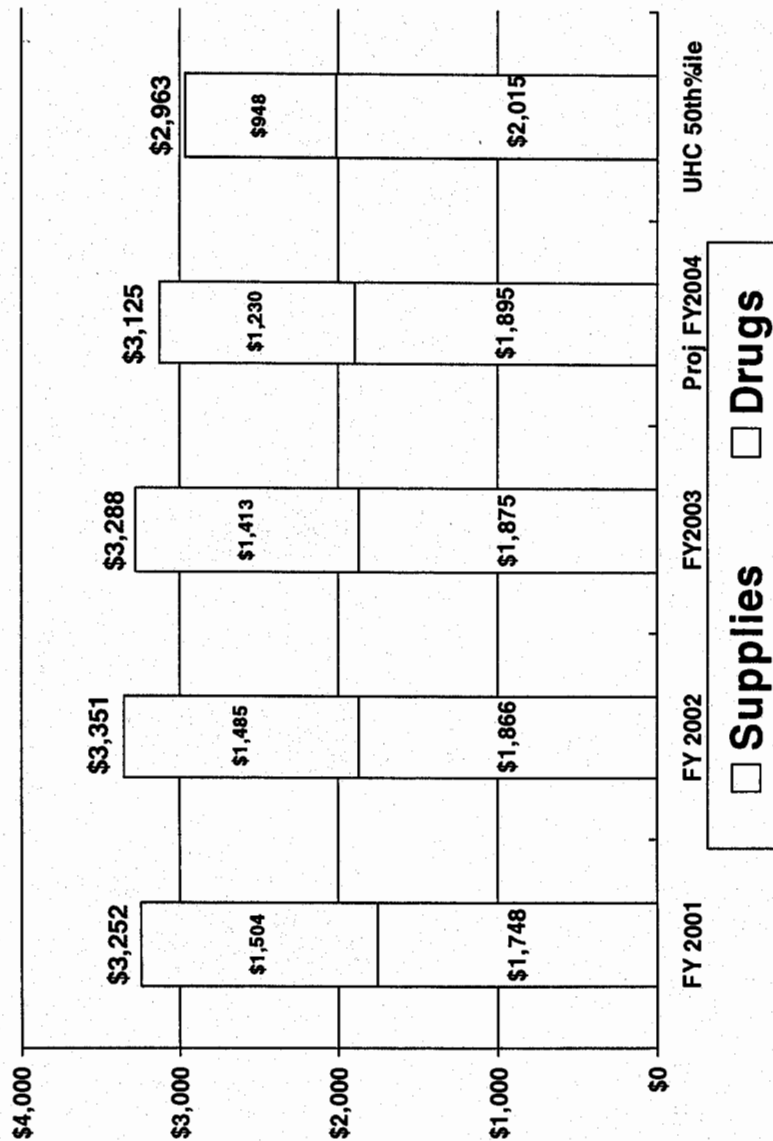
— Iowa Hospitals Data Bank, 2003

— Median for University HealthSystem Consortium (UHC) hospitals reporting to ACTION OI for 2003.



# Operating Costs per Unit of Service

## Supply Cost per Adjusted Discharge



\* Benchmark is the 50<sup>th</sup> percentile of the University Health System Consortium for the two quarters ending Dec 2003.

## **FY 2005 Expense Plan**

### **Programmatic Reviews**

Comprehensive review of programs that are not central to UIHC  
Mission

Development of accountability-based Medical Directorships

Review of Cost Sharing between UIHC and CCOM with focus on  
key performance indicators and accountability

Review of operations with opportunities for consolidation and  
shared staffing

Increasing throughput in all clinical areas with focused efforts on  
the Operating Rooms and Radiology

Utilization management in laboratory, pharmacy and respiratory  
services

## **FY 2005 Expense Plan**

### **Expense Management**

#### **Productivity Based Labor Budgeting**

Staff-hour per Unit of Service

Requiring performance at or above peer-group benchmarks

Monthly/ quarterly operations reviews

Agency utilization reduced from 132 FTE's at June 2003 to 59 at March 2004. Nursing leadership developing optimal flex staffing model

#### **Intense Supply Chain management process underway**

Pricing initiative through University Health Consortium/Novation

Vendor Consolidation

Product standardization

Right product/ right patient

Physician-driven utilization management

## **FY 2005 Expense Plan**

### **Length of Stay Management**

UIHC acute length of stay is at 6.93 days versus benchmark of 5.98 days

Continuum of Care Management and “Navigator Program” developed and has demonstrated improvement of .31 days YTD.  
Expansion of program underway

New Bed Placement Center opened to facilitate bed transfers and referrals

Peer comparison of physicians within clinical specialties

Development of clinical pathways

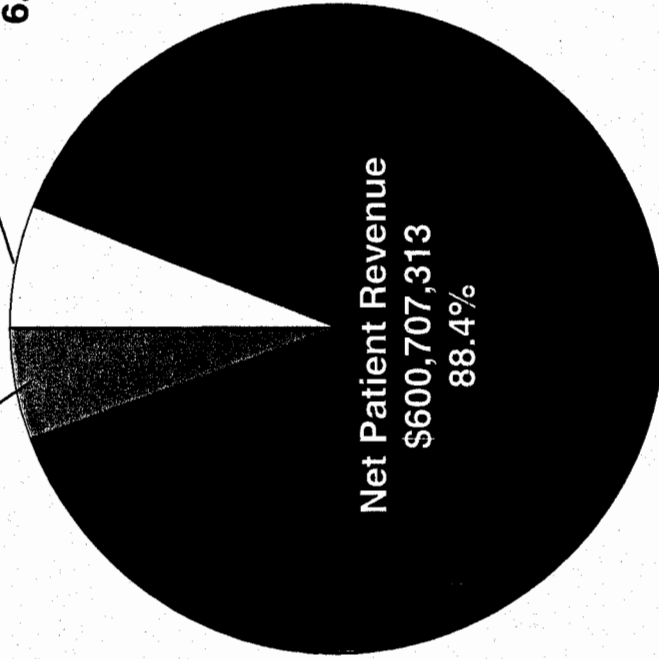
# Combined Hospitals Sources and Uses of FY05 Proposed Budget

Other Operating  
Revenue  
\$38,056,440  
5.6%

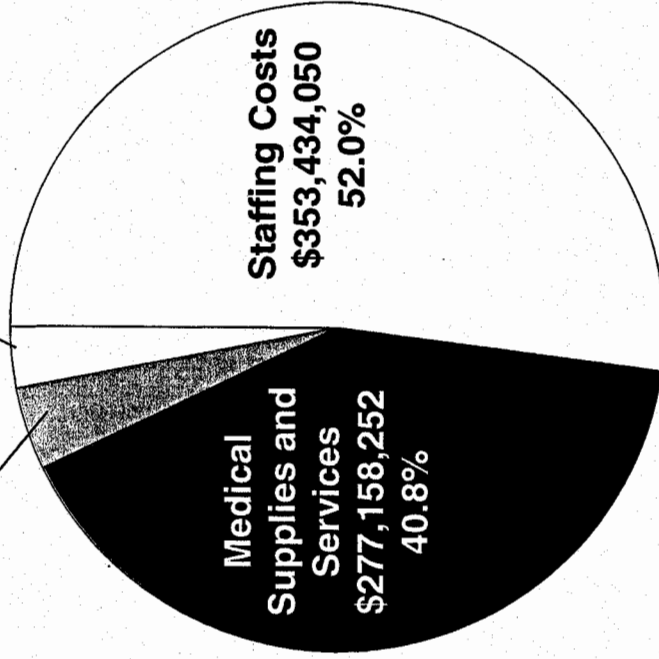
State Appropriation  
\$40,690,500  
6.0%

Utilities and Repairs  
\$28,260,535  
4.2%

Margin Reserve  
\$20,601,416  
3.0%

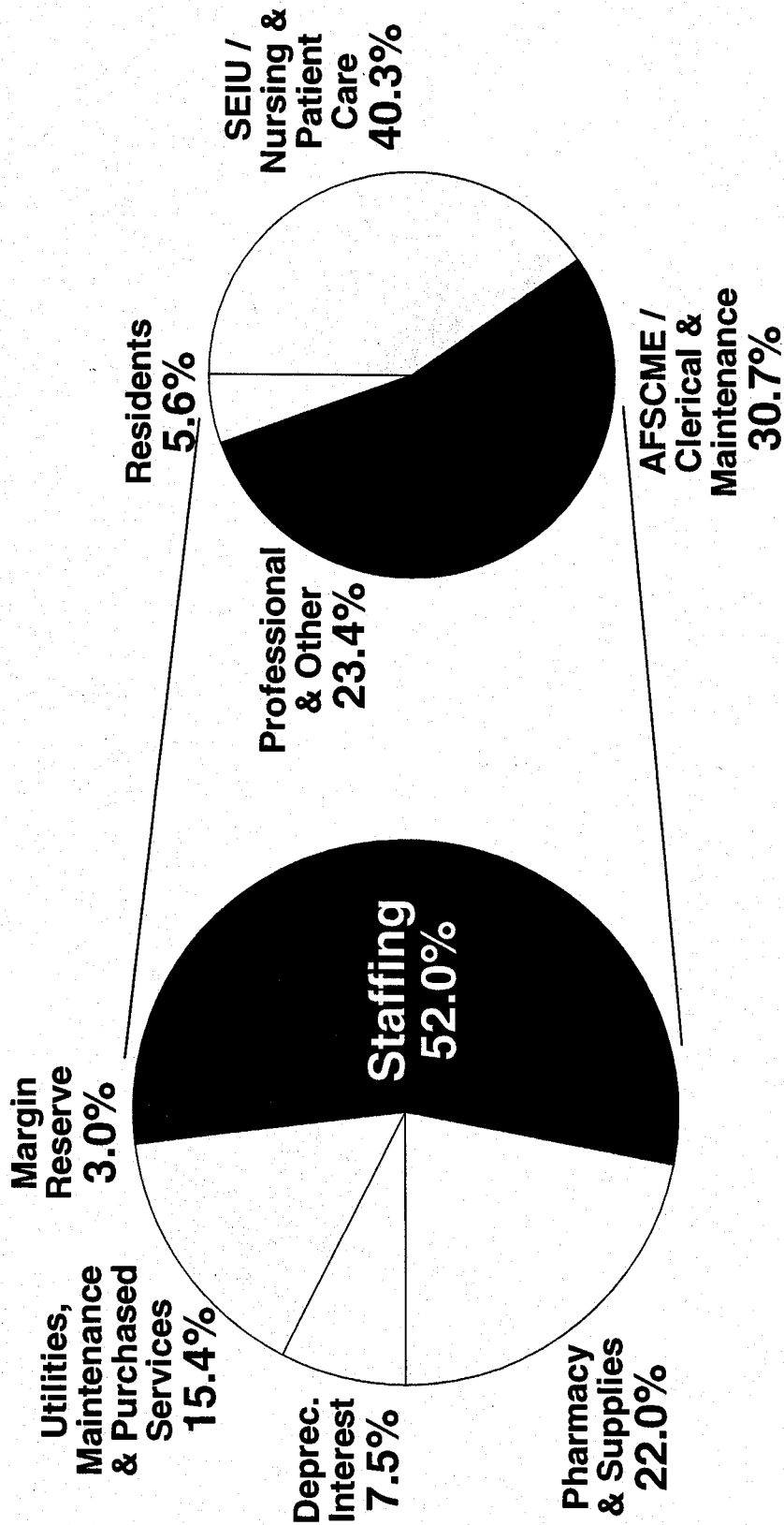


TOTAL = \$679,454,253



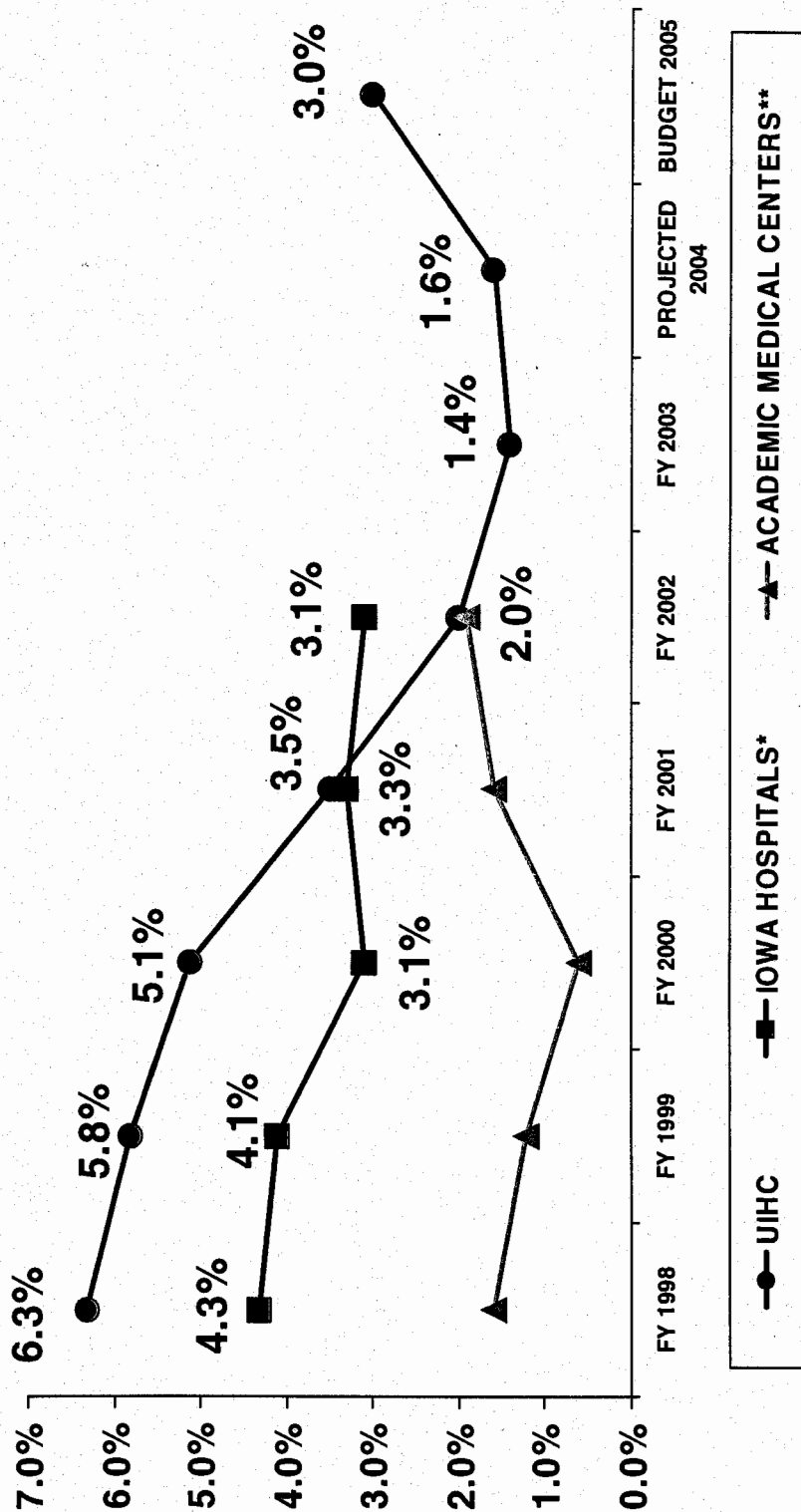
TOTAL = \$679,454,253

## UIHC Cost Structure FY 2005 Proposed Budget



Staffing costs comprise over half of UIHC expenses; the majority of dollars spent are for staff covered by bargaining unit.

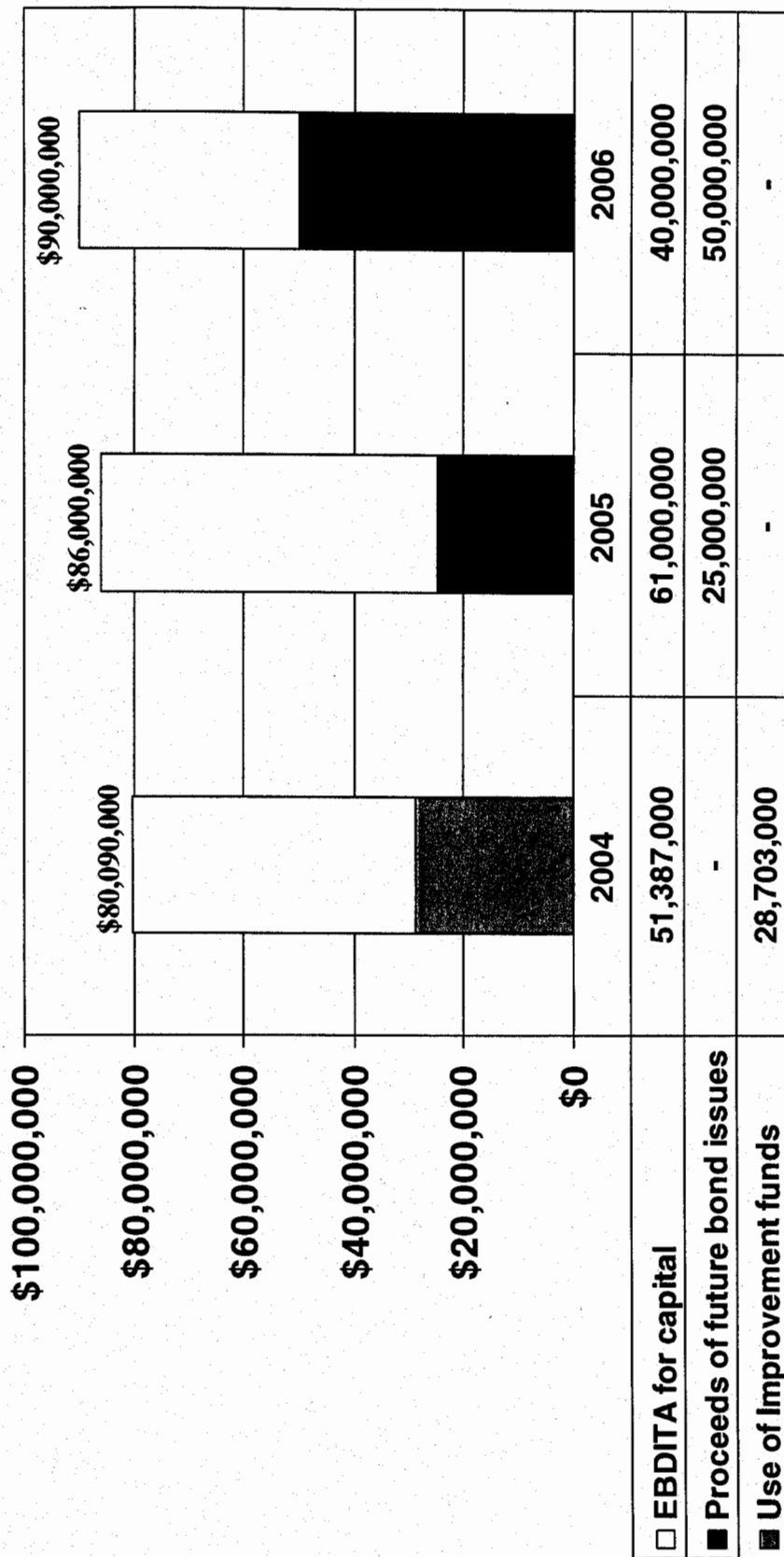
## Operating Margin Comparisons



\* Iowa Hospital Association Annual Report and DATABANK reports.

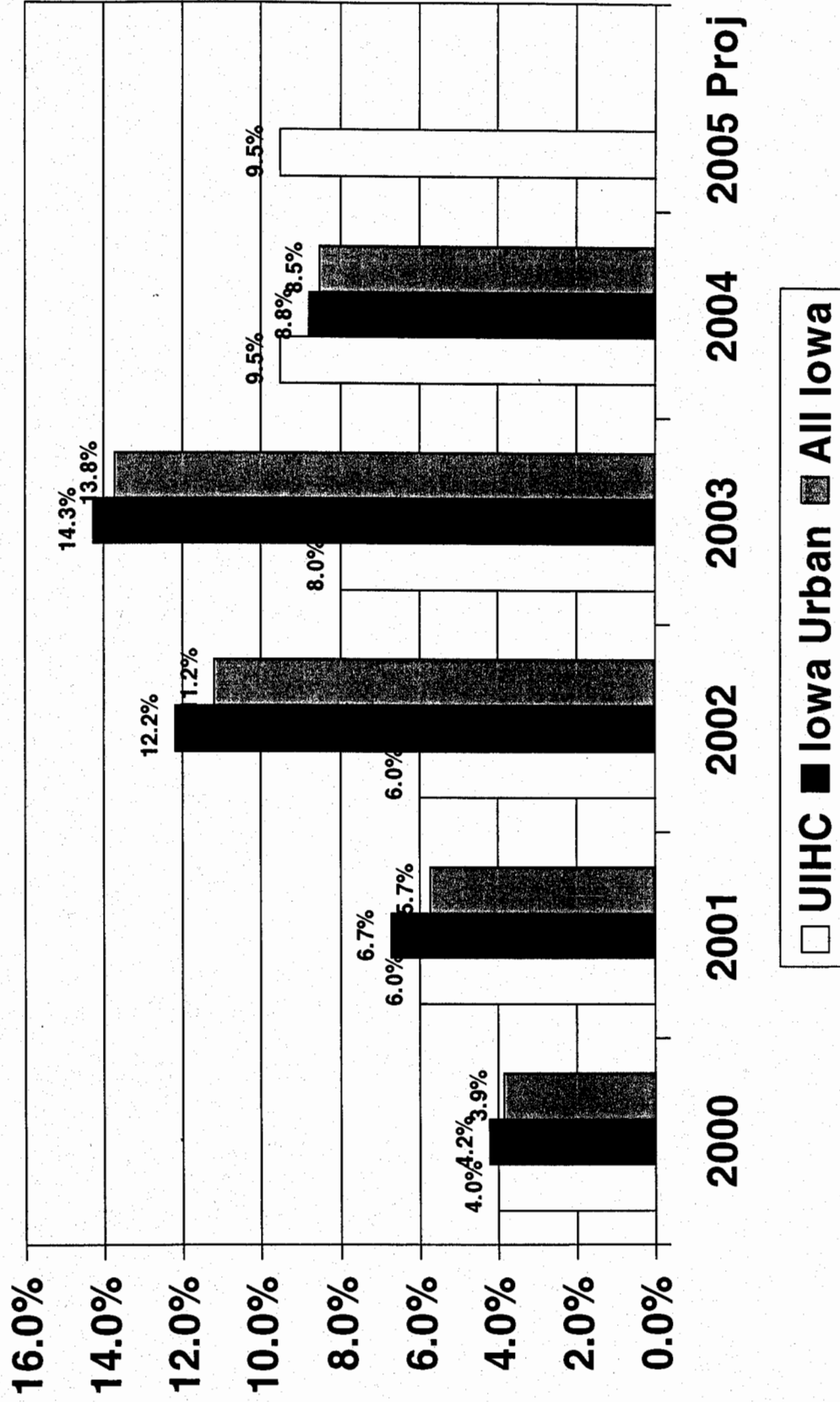
\*\* Annual COTH Survey of Hospitals' Financial and General Operating Data.

## University of Iowa Hospitals and Clinics FY 2005 Preliminary Capital Expenditure Budget





## Aggregate Rate Increase History



Source: Iowa Hospital Association Databank based on average inpatient charges per patient day

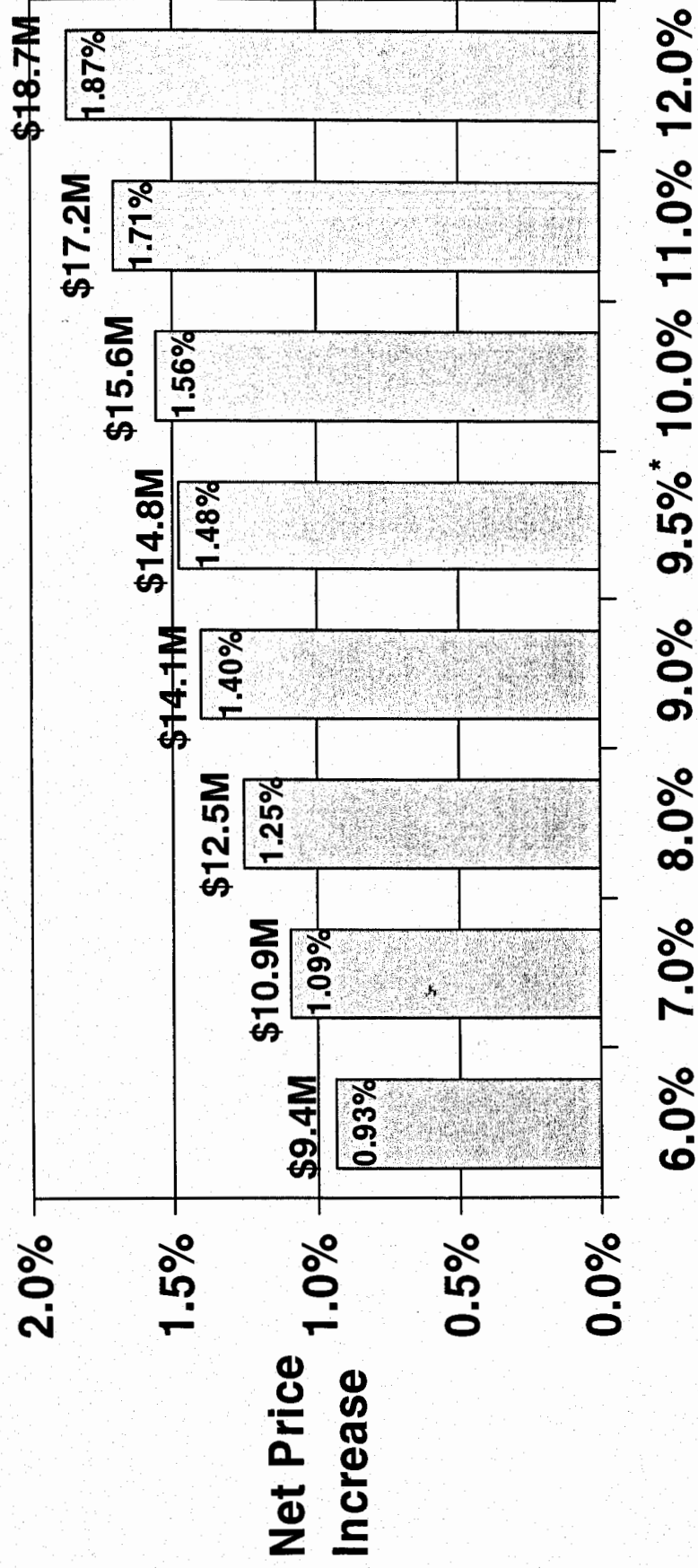
## **Why 9.5% rate increase?**

9.5% rate increase translates to less than 1.5% actual increase in net patient revenue

UIHC continues to lag academic medical center peers and historical state-wide rate increases

University HealthSystem Consortium members (UHC) anticipate rate increases in 7-20% range, averaging greater than 10%

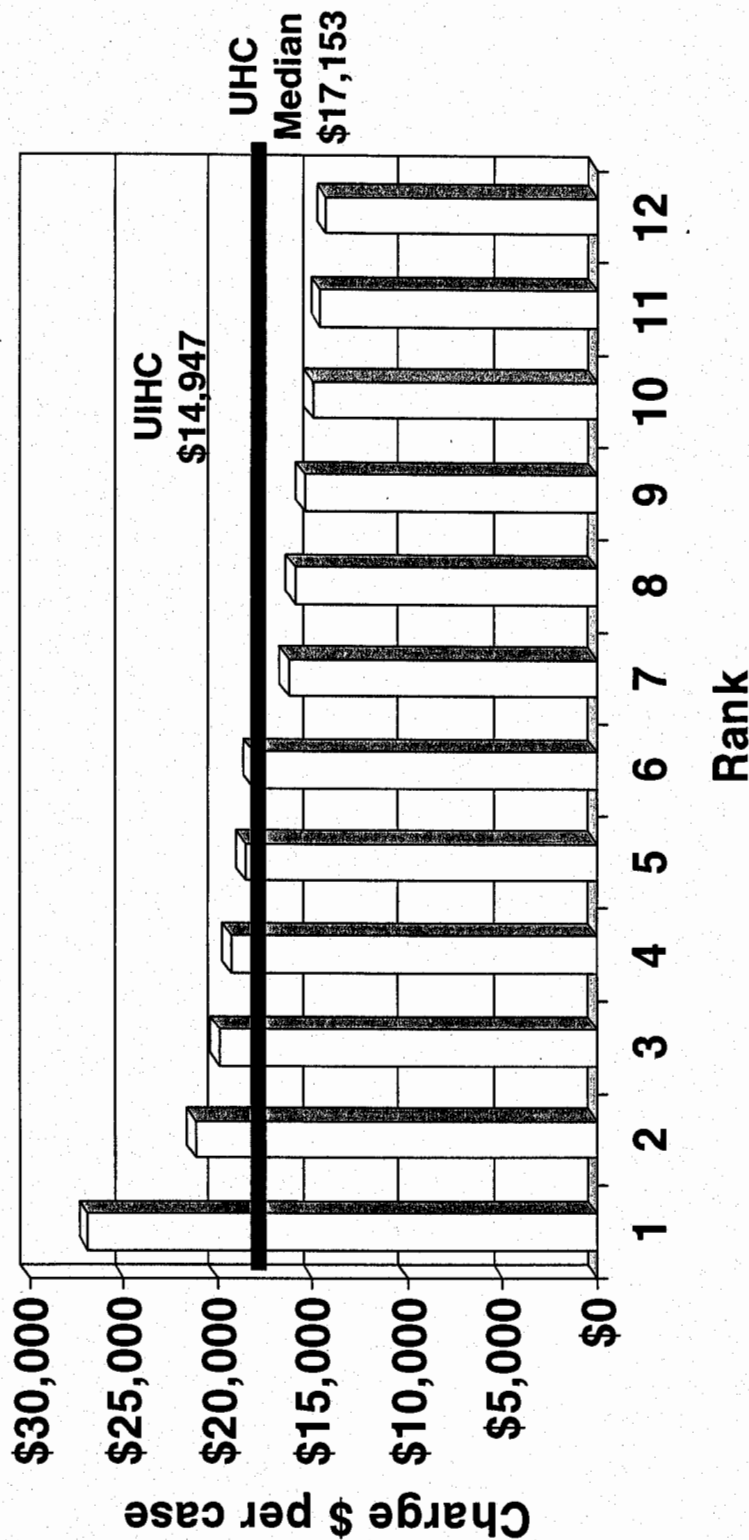
## Projected Percentage Net Price Increases at Alternate Gross Price Increases



### Gross Price Increase

\* A 9.5% increase will generate \$95.3M in gross charges and \$14.8M in net revenue

# Midwest Academic Medical Centers Case Mix Adjusted Charges per Discharge CY 2003



Source: University Healthsystem Consortium, case mix adjusted average charges per inpatient stay

## UHC Peer Comparison Average Charges per Discharge

	All UHC Members	Midwest Members	Sole AHC in Market	UHC Average Charges per Discharge \$14,947
<b>Minimum</b>	\$ 8,200	\$ 14,263	\$ 12,317	
<b>25th Percentile</b>	\$ 13,057	\$ 15,271	\$ 14,181	
<b>Median</b>	\$ 15,927	\$ 17,152	\$ 14,947	
<b>75th Percentile</b>	\$ 21,495	\$ 19,419	\$ 17,046	
<b>Maximum</b>	\$ 51,184	\$ 26,882	\$ 20,567	
<b>Iowa %tile</b>	44%	18%	50%	

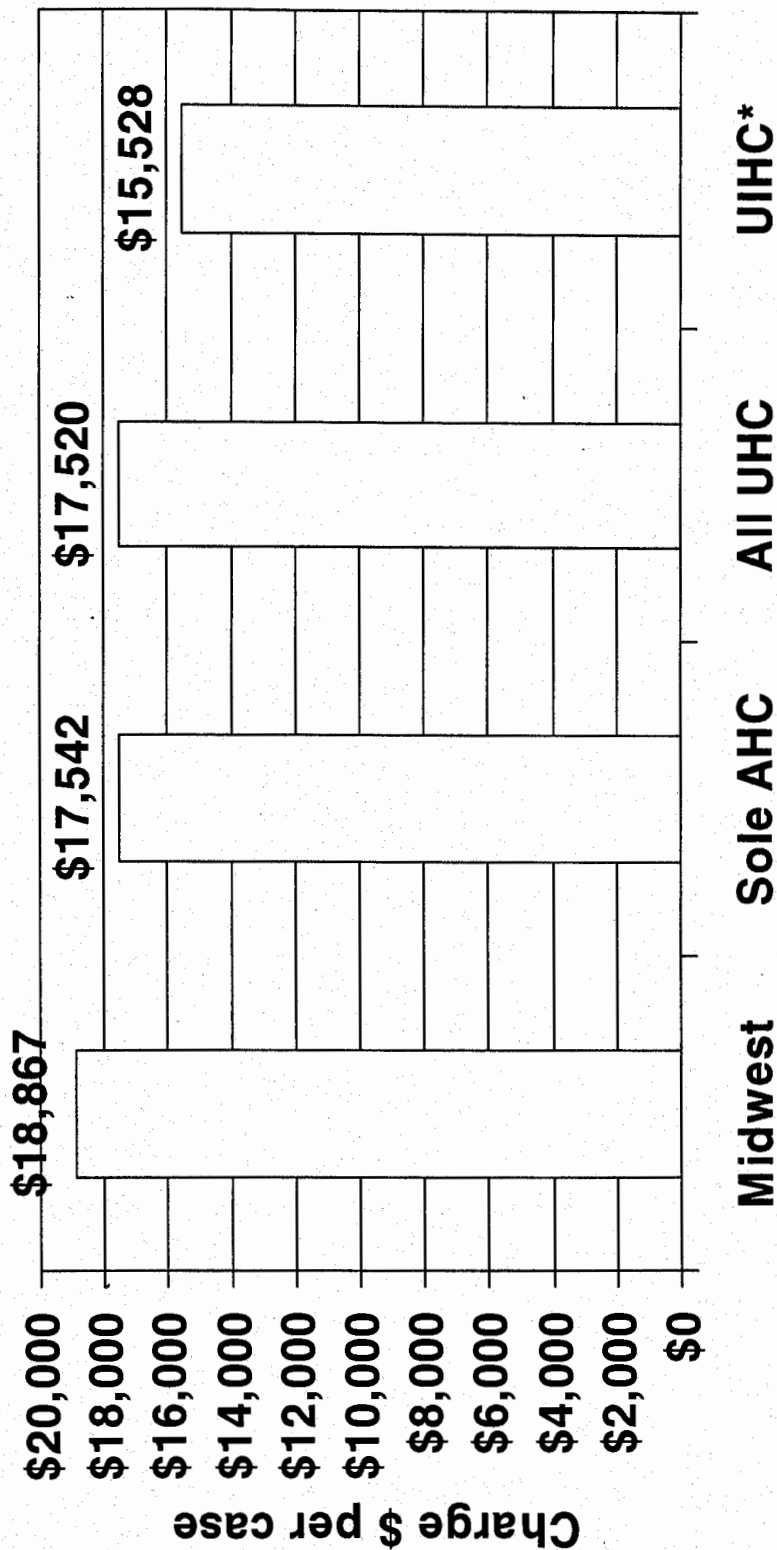
Source: University Healthsystem Consortium, case mix adjusted data

## UHC Peer Comparison Average Charges per Patient Day

	All UHC Members	Midwest Members	Sole AHC in Market	UHC Average Charges per Patient Day \$2,157
<b>Minimum</b>	\$ 1,595	\$ 2,039	\$ 1,879	
<b>25th Percentile</b>	\$ 2,251	\$ 2,544	\$ 2,295	
<b>Median</b>	\$ 2,759	\$ 3,127	\$ 2,629	
<b>75th Percentile</b>	\$ 3,629	\$ 3,546	\$ 2,954	
<b>Maximum</b>	\$ 9,651	\$ 4,452	\$ 3,337	
<b>UHC %tile</b>	19%	9%	10%	

Source: University Healthsystem Consortium, case mix adjusted data

# Projected UHC FY2005 Comparison with 9.5% Increase



Source: University Healthsystem Consortium, case mix adjusted average charges per inpatient stay, rolled forward with avg 10% CDM increase

\*Assumes .5 day drop in length of stay during FY2005

## **What Is The Impact Of Chargemaster Increases On Employers?**

If fully insured, no immediate impact. Risk is assumed by insurer.

If self-insured, impact of chargemaster increase limited to those services paid on discount from charges.

78% of UIHC total charges paid at fixed rate vs. discount

Those claims that are paid on discount pay at 85-90% of charges

Impact to any one employer would be minimal



## **What Is The Impact Of Chargemaster Increases On Patients?**

Self Pay patients will be impacted (<5% of total charges).  
Collections on this population is <30%.

Policy for discounts to the medically indigent being drafted based on the new OIG interpretation

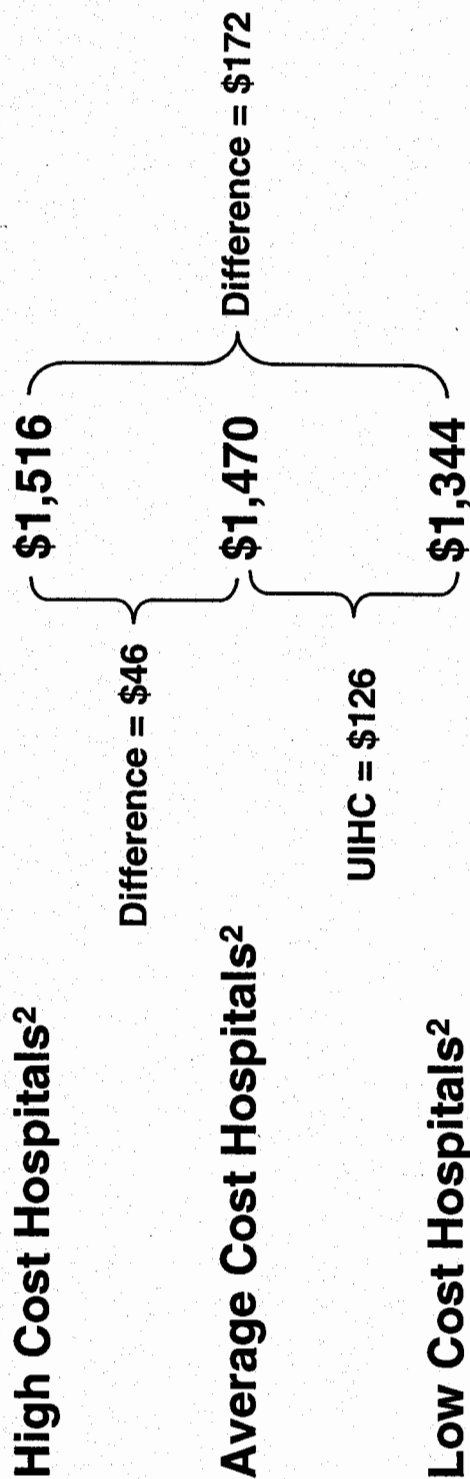
University HealthSystem Consortium analyzed the impact of higher charges on insured patients:

No impact on deductibles

Actual copayment impact is minimal, out of pocket maximums limit patient liability

# Impact of Higher Charges on Actual Copayment Surprisingly Small

## Average Out-Of-Pocket Copayment Per Admission, All Patients<sup>1</sup>



**Patients will have only nominal out-of-pocket copayment impact with chargemaster increases.**

<sup>1</sup> The benefit plan design applied to develop average out-of-pocket cost per admission is comprised of a \$300 deductible, \$1,800 OOP maximum, and 90% coinsurance.  
<sup>2</sup> Hospitals ranked in quartiles by case mix-adjusted allowable charges developed from more than 300,000 PPO admissions and corresponding outpatient visits modeled through three standard benefit plan designs: High Cost = top 25%, Average Cost = middle 50%, and Low Cost = bottom 25%.  
 Source: Milliman USA, Consulting Actuaries

## Out-of-Pocket Maximums Limit Impact on Patients

### Comparison Of One Patient's Out-Of-Pocket Copayments ("High Cost" vs "Low Cost" Hospitals, In-Network PPO Benefits)

	<u>"Low Cost"</u> <u>Hospital</u>	<u>"High Cost"</u> <u>Hospital<sup>1</sup></u>
Billed Charges	\$25,943	\$40,130
- PPO Discount	<u>-\$7,783</u>	<u>-\$12,039</u>
Allowable Charges	\$18,160	\$28,091
10% Patient Copay (Max. OOP=\$2,000)*	<u>\$1,816</u>	<u>\$2,000*</u>



**Cost Difference To Patient = \$184**

\* Assumes patient met none of his/her out-of-pocket limit prior to admission.  
<sup>1</sup> "High Cost" hospital is defined as a hospital in the upper quartile of case mix-adjusted allowable charges developed from more than 300,000 PPO admissions and corresponding outpatient visits modeled through three standard benefit plan designs.  
 Source: Milliman USA, Consulting Actuaries

## Conclusion

Patient Care Activity is projected to increase in FY 05.

Additional costs are expected to increase with the majority of these incremental costs in salary, benefits, supplies and implants.

UIHC is projected to finish FY 2004 with at least a 1.6% operating margin and anticipates making operational improvements in FY05 returning to 3.0% margin.

UIHC requests the Regent's approval of 9.5% increase.



# Discussion and Questions